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May 16, 2000

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VIA HAND DELIVERY

Mr. Vernon A. Williams
Secretary, Surface Transportation Board
Room 2215
1201 Constitution Ave., N.W.
Washington, D.C. 20423

Re: Ex Parte No. 582 (Sub-No. 1), Major Rail Consolidation Procedures

Dear Secretary Williams:

Enclosed are the original and 25 copies of the "Comments of Edison Electric Institute" for filing in the above-referenced proceeding, and a diskette containing the Comments in WordPerfect format.

Also enclosed are three additional copies for date stamping and return via our messenger.

Very truly yours,

Michael F. McBride

Michael F. McBride

Attorney for Edison Electric Institute

Enclosures

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Office of the Secretary

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UNITED STATES OF AMERICA
DEPARTMENT OF TRANSPORTATION
SURFACE TRANSPORTATION BOARD

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Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

COMMENTS OF EDISON ELECTRIC INSTITUTE

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Attorneys for Edison Electric Institute

Due Date: May 16, 2000
Dated: May 16, 2000

COMMENTS OF EDISON ELECTRIC INSTITUTE

Edison Electric Institute ("EEI"), the association of the investor-owned electric utility industry, hereby submits its comments on the Board's March 31, 2000 Advanced Notice of Proposed Rulemaking ("ANPR") commencing this proceeding. EEI applauds the Board for commencing this proceeding, and for expressing its willingness to consider significant, pro-competitive changes to its rail merger policy.

STATEMENT OF INTEREST

EEI filed a Statement on February 29, 2000, which is hereby incorporated by reference and attached as Attachment A. EEI included a statement of interest in that Statement to which the Board is referred. In that Statement, EEI explained that it is not against mergers, but rather urges the STB to follow an approach that protects customers and the public interest while allowing appropriate transactions to be consummated.

Included in EEI's Statement was a proposed list of issues to be considered in rail merger, acquisition or control proceedings. The effect of considering EEI's list, and applying it to proposed major rail transactions, would be to conform the STB's treatment of major rail transactions in a manner similar to the manner in which the Department of Justice, the Federal Energy Regulatory Commission, and the Federal Trade Commission treat the proposed transactions before those agencies.

EEI strongly urges the STB to follow the same approach to proposed rail mergers, acquisitions, and control transactions as DOJ, FERC, and FTC take in reviewing similar proposed transactions in other industries. Those agencies do so in a manner that increases competition while achieving the benefits of a proposed transaction. In this manner, customers are protected, while transactions in the public interest may proceed.

COMMENTS SPECIFICALLY IN RESPONSE
TO THE BOARD'S ADVANCED
NOTICE OF PROPOSED RULEMAKING

EEI agrees with the Board's statement in the ANPR, about its Decision in Ex Parte No. 582, "that the rail community is not now in a position to undertake what would likely be the final round of restructuring of the North American railroad industry [footnote omitted], and that our current rules are not adequate for addressing the broad concerns associated with reviewing any proposals that, if approved, would likely lead to two large North American transcontinental railroads." ANPR at 2. This concern is real, because Union Pacific, Canadian Pacific, CSX, and Norfolk Southern themselves said that result was inevitable if Canadian National and Burlington Northern Santa Fe go ahead with their merger application. "Open Letter to Rail Customers," January 11, 2000.

EEI agrees that 49 C.F.R. §1180.1(g), the "one case at a time rule," should be eliminated. While such a rule may make sense for other industries which have numerous competitors, it does not make sense where the "final restructuring" of an industry is clear. Because the Board has found that the "final restructuring" of the railroad industry would lead to two large railroads, that outcome must be considered in every major rail consolidation proceeding.

EEI agrees with the Board that "3 to 2" shippers, not just "2 to 1" shippers, should get relief in a rail merger proceeding, that the "one-lump theory" should be treated as a theory that must be proved applicable rather than shown through facts to be inapplicable; that smaller railroads can and should play a larger role in the rail network; that the Board should adopt meaningful service performance measures; and that the Board should revise its approach to consideration of benefits in a rail merger proceeding. See ANPR "Overview," at 5.

The Board asked for specific proposed rule changes. ANPR at 5. EEI's specific proposals are as follows:

1. Amend 49 C.F.R. § 1180.1(c)(2)(i) as follows (with new language in **bold**: "If two **or more** carriers serving the same market consolidate, the result would be the elimination of competition between the **carriers.** Even if the consolidating carriers do not serve the same market, there may be a lessening of potential competition in other markets. While the reduction in the number of competitors serving a market is not in itself **necessarily** harmful, a lessening of competition resulting from the elimination of a competitor may be contrary to the public interest. The Board recognizes that rail carriers face not only intramodal competition, but also intermodal competition from motor and water carriers. The Board's competitive analysis depends on the relevant market(s). In some markets the Board's focus will be on the preservation of effective intermodal competition, while in other markets (such as long-haul movements of bulk commodities) effective intramodal competition may also be important.

Specifically, the Board will (a) ordinarily not permit carriers to close gateways as a result of a consolidation; (b) consider the loss of competition from three carriers to two to justify a remedy for the shipper; (c) consider evidence that the "one-lump theory" is not applicable to a particular merger if the evidence so warrants; (d) consider the necessity that a consolidating carrier offer "bottleneck" rates from an origin or destination to an interchange point where the shipper would be able to obtain service from another carrier; (e) consider the appropriateness of setting a single, competitive switching rate within a terminal area or at a point of interchange between carriers; (f) consider whether any premium over book or market value, or the acquisition itself, might cause shippers to be

exposed to a risk of rate increases or loss of adequate service, and whether a rate "cap" or other remedy is appropriate; (g) consider whether well-defined service performance guarantees should be required; and (h) consider whether "paper barriers" and "steel barriers" on or with the carriers seeking to consolidate should be eliminated, all as conditions of approval.

Gateways. Whatever claimed justification there may have been for closing gateways, such as the allegation that they were "redundant," the service problems and lack of competition brought on by rail mergers should militate strongly against closure of any more gateways, and indeed that the Board should consider opening certain gateways previously closed.

"Three to Two Shippers". There are still a number of shippers who are in a "3 to 2" situation and in which a consolidation could cause loss of competition. EEI is aware, for example, of a major rail-to-barge facility operated by one of EEI's members that is served by UP, BNSF, and Illinois Central (now CN). A merger of BNSF and CN would reduce the number of competitors from 3 to 2. Given the service problems on UP, for example, or the fact that the shipper had to sue BNSF to get service under its contract, it cannot be presumed that the loss of service from CN would not cause a reduction in competition.

"One-Lump" Theory. The "one-lump" theory is only a theory. It should be treated as such by requiring evidence that it is applicable. The Board should not view with disfavor evidence showing that the theory is inapplicable, such as that a prior merger of an origin carrier and destination carrier into one of the applicant carriers did, indeed, cause rates to rise in comparison to other, similar rates, or that the carriers seek to consolidate to acquire the information that would permit them to better exploit a captive shipper's captivity. (The theory is inapplicable, for example, if the destination carrier sets the rate but has insufficient information about how the origin carrier sets its rates.) There is no reason to let the theory stand in the way of proof that it is inapplicable, for facts should triumph over theory. Drs. Kahn and Dunbar presented a compelling study of the inapplicability of the "one-lump theory" in ACE, et al.-18 in Finance Docket No. 33388, which the Board should reconsider.

"Bottleneck" Rates. One of the major reasons railroads merge is their claim of increased "single-line service." They sell that claim on the ground of greater efficiency. What they do not say is that the same single-line result is anticompetitive, because typically the consolidating carriers will not quote rates to connecting carriers if the consolidating carriers can carry the shipper's goods from the same origin to the same destination. That is anticompetitive, and a requirement that consolidating carriers quote "bottleneck" rates upon request would allow the shipper to challenge that "bottleneck" rate if need be, and to obtain competition in any event. This proposed rule would not necessarily require the Board to overturn its entire "bottleneck" series of decisions, although EEI would support that.

Single Switching Rate. Reciprocal switching permits traffic to be interchanged without discrimination. High switching rates can also discourage shippers' competitive options. The Board should adopt a presumption in favor of reciprocal switching at the same rate in a terminal area for all connecting carriers. It should also be vigilant in determining that switching charges are sufficiently low to encourage shippers' competitive options while permitting carriers to recover their costs. In this respect, it may be appropriate to set the switching rate at a level above variable cost but below total costs if such is necessary to permit competition to continue or to increase to an appropriate level. The Board's prior determinations of the appropriate level of a switching charge have, at times, reduced competition.

Acquisition Premium. It is never appropriate to subject customers to rate increases as a result of acquisition premiums, yet that has occurred in the Conrail proceeding, where CSX and NS stated their intent not to raise rates but then have done so, or attempted to do so. To be sure, they or the Board could say "but the increases are due to cost increases." But that is impossible to prove; the presumption must be that any increase is due to acquisition premiums.

Moreover, it is unhealthy for the railroad industry to be, in essence, encouraged to pay acquisition premiums for other railroads, on the understanding that the Board will not impose rate caps or other shipper protection remedies. CSX and NS are perfect examples; they have paid enormous premiums, over the opposition of EEI members before most of the premium dollars were paid (in Finance Docket No. 33388, in April 1997), and now are in financial difficulty.[1]

Service Guarantees. Clearly, service has gotten worse instead of better as a result of many recent mergers. (The CN-IC merger may be an exception.) But mergers have been promoted as making service better ("single-line service" has been the constant mantra), despite the harm to competition that the Board has allowed as an inevitable cost. (The loss of the SP in the "Central Corridor," for example, as a result of the UP-SP merger, and the substitution of weak competition at best from UP's tenant, BNSF, is an example that has harmed competition for Western low-sulfur coal.) If mergers are going to be pursued in the future, shippers should not continue to pay the price when promises come up short. Rather, the Board should guarantee

[1] NS, for example, just had its debt downgraded by Standard & Poors. Both CSX and NS have reported sharply reduced earnings, and their stock prices have plummeted, all within 12 months of the Conrail "split" date.

shippers that service will not get worse, or the consolidating carriers must compensate shippers for their economic losses. To that end, the Board should require that **meaningful** service measures for individual shippers be published, such as elapsed transit times for coal unit train movements, or other statistics that shippers rely on as their measure of service, rather than such railroad-centered statistics such as train velocities and terminal dwell times, which are meaningless to individual shippers.

The shippers will need to present evidence of their losses, but it should be clear before they do that service has fallen short so that relief will be provided if the evidence demonstrates the loss. The hearing, in other words, should not be about **liability**, but about **damages.** Railroads should be responsible for real damages, in dollars, not just replacement cars or make-up service. The Board should also be willing to provide injunctive relief in appropriate circumstances.

"Paper" and "Steel" Barriers. Lastly, prior transactions between Class I carriers and smaller carriers have reduced competition. Shortlines have not been allowed to interchange with carriers other than the seller, or the seller has even sold only so much track as prevents the smaller carrier from physically being able to interchange with any other carrier.[2] These "steel" barriers are especially egregious means of preventing competition from carriers operating lines that the ICC or the Board have allowed to be spun off in prior transactions, including many mergers or other acquisitions. The net effect has been to keep smaller carriers from providing

[2] A particularly good example of a "steel" barrier is the Indiana Southern line from southern Indiana toward Indianapolis, which was the subject of extensive litigation in Finance Docket No. 33388. See IP&L-3, ISRR-4. Indiana Southern was sold track that ended at Milepost 6, which prevented Indiana Southern from reaching the Indianapolis Belt except over Conrail.

shippers with competition, or even with needed service. The Board should adopt a presumption against **any** new "paper" or "steel" barriers, and should conclude that prior ones are presumptively contrary to public policy. In a consolidation proceeding, the Board would thereby invite shippers or other interested parties to propose remedies for uncompetitive situations created by prior consolidation transactions.

CONCLUSION

For the foregoing reasons, the Board should adopt as issues to be considered in major rail merger, acquisition, and control proceedings the list of issues in EEI's Statement of February 29, 2000, and should adopt the specific rule changes proposed herein.

Respectfully submitted,

Michael F. McBride

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Attorneys for Edison Electric Institute

May 16, 2000

CERTIFICATE OF SERVICE

I hereby certify that I have served this 16th day of May 2000, a copy of the foregoing "Comments of Edison Electric Institute" upon each party of record.

Michael F. McBride

Michael F. McBride

ATTACHMENT A

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February 29, 2000

VIA HAND DELIVERY

Mr. Vernon A. Williams
Secretary, Surface Transportation Board
Room 2215
1201 Constitution Ave., N.W.
Washington, D.C. 20423

Re: Ex Parte No. 582, Public Views on Major Rail Consolidations

Dear Secretary Williams:

Enclosed are the original and ten copies of the "Statement of Edison Electric Institute" for filing in the above-referenced proceeding, and a diskette containing the Statement in WordPerfect format.

Also enclosed are three additional copies for date stamping and return via our messenger.

The oral presentation on Thursday, March 9 will be made by Edward H. Comer, Esq., EEI's Vice President and General Counsel. He will be accompanied by the undersigned.

Very truly yours,

Michael F. McBride

Michael F. McBride

Attorney for Edison Electric Institute

Enclosures

UNITED STATES OF AMERICA
DEPARTMENT OF TRANSPORTATION
SURFACE TRANSPORTATION BOARD

EX PARTE NO. 582

PUBLIC VIEWS ON MAJOR RAIL CONSOLIDATIONS

STATEMENT OF EDISON ELECTRIC INSTITUTE

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Attorneys for Edison Electric Institute

Due Date: February 29, 2000
Dated: February 29, 2000

Statement of Interest

Edison Electric Institute ("EEI"), the association of investor-owned electric utilities, hereby submits its statement on rail merger policy. EEI applauds the Board for convening this proceeding, because the railroad industry is at a crossroads, and the result of this proceeding may be the most important factor in determining what the railroad industry will ultimately look like in the future.

EEI's primary interest in this matter stems from the transportation of coal, which is used to generate well over 50% of the electricity in the Nation. Coal also is the single largest source of revenue to the railroad industry, accounting for at least 25 percent of the gross revenues of the Class I railroads and, certainly, more of their net revenues. Railroads have enjoyed a revival of fortune in the last 20 years in large part because of the substantial increase in transportation and use of coal. Not only has the volume of coal increased, but also the average length of haul has increased substantially as a result of the switch by many utilities to Western low-sulfur coal to comply with the requirements of the Clean Air Act. Those requirements have only increased the demand for such coal since Congress amended the Act in 1990 to create limitations on the emissions of sulfur dioxide which in turn has increased the demand for low-sulfur coal. Much of that coal is located in the area from southern Montana through Wyoming to Colorado and Utah. Much of the investment capital for the railroads' ability to move Western coal to market has come from the utility industry in the form of long-term contracts which permitted the railroads to finance track and power purchases. In many, if not most, cases, the coal actually moves in shipper-owned or leased cars further alleviating capital requirements for the carriers. Western coal is so important to the railroads that one might as well place a "$" sign over the entire region.

In the entire coal-producing Western region, as well as in the coal-producing region of Appalachia, one finds, with limited exceptions including the joint line in Wyoming, either single-railroad service, no competition between coal sources, or both. This lack of competition distinguishes the railroad industry from the electric industry. It will be difficult to receive the benefits of competition between electric generators when fuel transportation is not equally competitive. With at least one-fourth of the revenue of the railroads coming from these two regions, competitive coal transportation is essential to the economic well being not only of coal, but the economy.

Recently, in Finance Docket No. 33408, the Board approved the construction of a new line into the Powder River Basin by the Dakota, Minnesota & Eastern Railroad ("DM&E"), subject to environmental considerations. The Board has also always considered the mere potential of the building of a new line to serve a particular facility ("build-ins" or "build-outs"), if feasible, as sufficient to create competition that must be protected in rail consolidation proceedings. So, too, the Board must now treat the potential competition from the DM&E as sufficient potential competition to be worthy of protection. As a practical matter, creation of a third competitor in the Power River Basin is the single most important railroad transportation concern of EEI at the present time.

Position of Edison Electric Institute

Mergers are a fact of life in today's economy. Indeed, many of EEI's members have merged over the last several years, and some of its members are seeking approval to merge at the present time. But competition among electric companies in the United States is greater than ever. The Federal Energy Regulatory Commission ("FERC") has, at the same time it has approved most utility mergers, promoted competition in the utility industry and protected customers from any potential adverse effects of such mergers,[1] through measures such as open access to utility transmission facilities and development of regional transmission organizations subject to regulation by FERC. FERC also applies a rigorous competitive analysis using the DOJ-FTC guidelines to evaluate electric mergers. And these mergers are taking place when there is considerable investment by new entrants in the generation of electricity. It is thus hard to imagine that the electric industry will ever have fewer competitors than the number of Class I railroads now in existence. Moreover, FERC has a much broader definition of competitive harm than does the STB and it does not permit customers to be charged higher rates because of acquisition premiums or otherwise to be harmed as a result of a merger.[2]

In contrast, the Board's existing merger policy, which the Board has characterized as "pro-merger," has encouraged the rail mergers of the last 20 or more years that have caused the Class I railroads to shrink in number from about 40 in 1980 to about 7 today, with no more than two railroads now serving any significant market. Unlike FERC, the Board has undertaken no consistent policy to expand customer choices in any significant way, with the possible exception of the Joint Line in the Powder River Basin and some of the shared access areas of Conrail.

---

[1] Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement, III F.E.R.C. Stats. & Regs. ¶ 31,044, at 30,123 (1996).

[2] Duke Energy Moss Landing LLC, et al., Order Accepting for Filing and Suspending Reliability Must-Run Tariffs, Summarily Dismissing Proposed Acquisition Adjustment, Consolidated Tariffs and Establishing Hearing Procedures, 83 F.E.R.C. ¶ 61,318 (1998), reh'g denied, 86 F.E.R.C. ¶ 61,227 (1999). State regulators, in ruling on utility mergers, have frequently required actual rate decreases or moratoriums on rate increases as terms and conditions of merger approval.

The recent announcement that Burlington Northern Santa Fe ("BN") and Canadian National ("CN") propose to merge has, as the Board well knows, triggered a response from Canadian Pacific, CSX, Norfolk Southern, and Union Pacific opposing the CN/BN merger but stating clearly that, if the Board were to approve it, the inevitable result would be two railroads in North America. See "Open Letter to Rail Customers," published January 11, 2000. That would be unacceptable unless new entrants were able and willing to use the rights-of-way of the two surviving railroads to provide the competition that is necessary.

A future in which there are only two freight railroads in the United States threatens DM&E, or indeed any possibility of a third, coal-carrying Western railroad, because the remaining railroads are not going to allow such a competitor to compete with them in the West or through friendly connections to the Eastern carriers that they would have had to merge with to reduce the number of railroads to two. Thus, future mergers might well require a variety of "Central Corridor" remedies to assure friendly connections for a third coal-hauling railroad in the West.

Railroads can only thrive by serving their customers, not the other way around. They have a common carrier duty to serve the public, but that duty carries with it not just the obligation to quote a rate and to get a shipper's goods to market. Rather, railroads have a responsibility to provide **world-class service.** The promise of the Staggers Rail Act of 1980 was that the railroads would do so if permitted to operate in a **competitive environment** but that promise remains unfulfilled. Instead, the recent mergers, starting with the Union Pacific/Chicago & NorthWestern merger, have resulted in worse service and, at times, have threatened electric reliability and produced higher rates. The shippers, by and large, have suffered as much or more as have the railroads and their stockholders. The service crisis following the UP/SP merger cost this Nation billions of dollars in permanent damage to the economy. Texas alone lost over $1 billion from that crisis. The electric utility industry suffered grievous service failures as a result of the UP/C&NW and UP/Southern Pacific mergers in the West and they cannot afford similar threats to the reliability of the electric system in the East following the split of Conrail between CSX and Norfolk Southern. The reliability of the Nation's electric system should not be subjected to additional risks while the current service problems in the East are unresolved.

In the new environment of wholesale competition between various electric generators, a better relationship between the rail carrier and both the mine and the electric generator is no luxury but a necessity.[3] A competitive electric industry does not have the luxury of carrying long inventories of coal, which might make rail service problems more manageable. It will be necessary for the rail industry to provide nearly just-in-time service as frequently as possible in order to protect the role of coal in electric production. While these concerns might be expected to cause service providers facing competition to lower rates to keep their customers, EEI is concerned that reducing rail competition will lead to higher rates.

For all these reasons, EEI urges the Board to revise its rail merger policy to the broadest extent possible. This is necessary to permit consideration, in proceedings before the Board, of all possible issues of market power, loss of competition and "downstream" effects of the transaction at issue. Specifically, the Board should consider:

---

[3] See, e.g., "Broader Power Markets Created by ISOs Could Offer Coal Shippers 'a Larger Range of Opportunities,'" Inside FERC, May 18, 1998 (comments of FERC Chairman Hoecker).

1. Loss of competition;

2. Loss of competitors;

3. Ability of the Board, if any, to replace the lost competition or competitors that result from a consolidation;

4. The geographic scope of the railroad created by the consolidation and whether the consolidated railroad will be able to provide efficient and timely service in the area;

5. Whether the proposed consolidation is likely to trigger additional mergers leading to a two-carrier North American duopoly;

6. Whether the proposed merger is likely to reduce the ability of new entrants, or non-Class I railroads, to enter markets;

7. Whether origin, not just destination, competition for commodities such as coal is reduced or eliminated by railroad consolidations;

8. Whether the assumption the Board has made in prior consolidation proceedings that there is only "one lump" of monopoly profits and the origin or destination carrier with the monopoly can keep all or most of those monopoly profits is inconsistent with the railroads' efforts to extend their market reach through the consolidation to obtain a greater share of those monopoly profits, and to increase the monopoly profits available on a given movement;

9. Whether "2 to 1" shippers -- i.e., those with service from two railroads which are merging into one -- are the only shippers who should get relief in a railroad consolidation proceeding, or whether the reduction of competitors, especially at origin, from "3 to 2" or "4 to 3" is grounds for relief;

10. Whether railroads should be responsible for losses due to service failures, especially those service failures that result from railroad consolidations;

11. Whether acquisition premiums have been paid to effect a consolidation transaction, thus causing the surviving railroad to be under pressure to raise rates;

12. Whether, even if an acquisition premium has not been paid, the likely outcome of the transaction is to reduce the value of the railroad's publicly traded stock, thereby causing pressure to raise rates; and

13. Whether customer protections that are standard in other regulated industries, such as rate caps, should be required as a prerequisite to any further consolidations.

Conclusion

EEI applauds the Board for conducting this most important proceeding, and for doing so before considering the application of BNSF and CN to consolidate. EEI urges the Board to adopt a new rail consolidation policy that more closely follows the merger policies of other Federal regulatory agencies, such as FERC and the Department of Justice, and to weigh those considerations in determining whether to approve any further consolidations.

Respectfully submitted,

Michael F. McBride

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